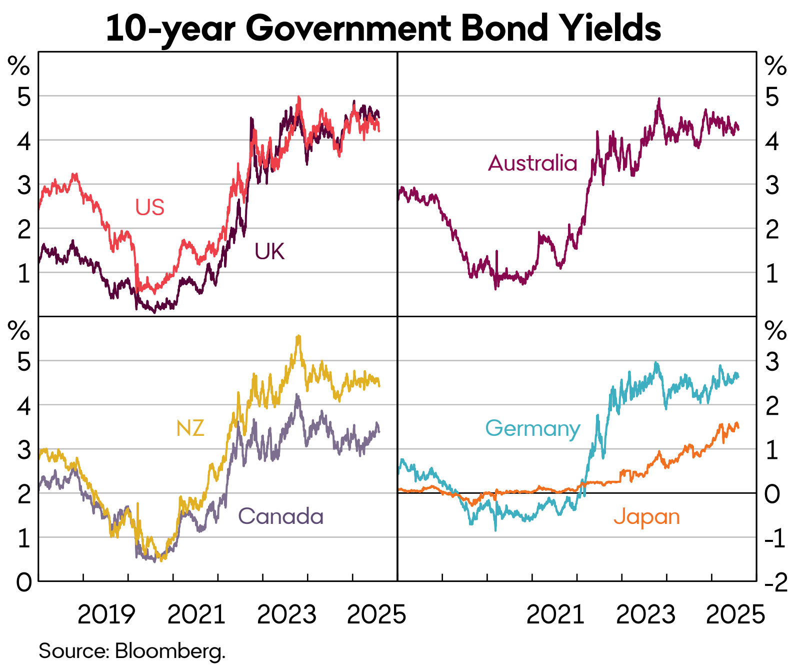
September 2025

Economic and market update

Economic Overview – as at 18th September 2025

Global markets

Stock markets around the world continue to be buoyed by the short-term impact of further rate cuts (especially the rebooting of the US easing cycle) and the medium-term assumption that technological advances will deliver a sustainable boom. Fresh record highs for the Nasdaq and S&P500 coincide with markets pricing of further Fed cuts on top of robust corporate earnings - but not deterred by bond yields (refer chart below) that are elevated in the face of fresh questions around fiscal sustainability. US bond yields have eased, however the fiscal outlook in France and the UK has again captured the markets' attention and UK 30-year gilts have risen to their highest level since 1998.



The US Federal Reserve cut rates as expected last night by 25 bp to a 4-4.25% band with an 11-1 vote (newly sworn-in Governor Stephen Miran voted for a 50 bp cut), as Chair Powell conceded that 'labor demand has softened, and the recent pace of job creation appears to be running below the break-even rate'. The subtext of pressure from the White House to ease rates more urgently wasn't evident in the Fed's statement, and the fact that there was only one dissenter suggests a shallower easing path ahead than markets had been expecting. Powell sensibly noted 'our obligation is to ensure that a one-time increase in the price level does not become an ongoing inflation problem' - but the rate cut decision did coincide with an increase in Fed forecasts for PCE inflation to 2.6% (from 2.4%). Markets were volatile in the wake of the decision, but the 10-year bond yield settled slightly higher at 4.08%. US jobs data has continued to disappoint with more downward revisions to payrolls, and industrial production has been mediocre although retail sales data has been more resilient.

The Bank of Canada also resumed their easing cycle last night (after a 6-month break) with a 25bp cut to 2.5% as US tariffs and policy uncertainty continue to weigh on sentiment and labour markets. The cut was a unanimous decision and Governor Macklem said he would be ready to cut rates again if risks to the economy intensified. Economic growth has recovered but unemployment is up to 7.1%.

The European Central Bank kept rates unchanged last week as expected and didn't appear in any rush to cut rates further as the ECB noted 'inflation is currently at around the 2% medium-term target', but acknowledged the uncertain global environment. The US tariff on Europe has been set at 15% after a 'reciprocal framework' was agreed (bringing down the duty on European cars from 27.5% to 15%) meaning US tariffs will now apply to wine, notably from France and Italy. Meanwhile, France has another new PM (its fifth in two years) in Sebastien Lecornu, after a vote of no confidence in his predecessor Bayrou around budget cuts amid spiralling public debt. Fitch subsequently downgraded France's credit rating to A+ (its lowest level on record) and French 10-year bond yields rose to 3.5%. The Bank of England are also expected to keep rates on hold tonight (at 4%) after CPI remained at 3.8% with core inflation only slightly lower at 3.6%. The impending UK Budget in late November will be highly challenging for Chancellor Rachel Reeves with higher taxes expected and government borrowing costs at their highest levels since the late 90s. The UK has been pushing for the US to lower its 10% blanket tariff (e.g. for steel exports) but thus far with no success.

China's economic activity data for August showed a further loss of momentum adding pressure to authorities to provide additional stimulus, despite the recent rise in survey PMIs for August. Retail sales growth slowed again to 3.4% y/y and while services activity remains reasonable the support from recent measures (e.g. consumer goods trade-in programs) may need revival. Industrial production also decelerated down to 5.2% (from 5.7% y/y last month) and investment data was weak across the board, especially for manufacturing, infrastructure and real estate. Meanwhile, the trade truce with the US continues with Treasury Secretary Scott Bessent and China's Vice President He Lifeng leading further talks, after the US announced it would not impose additional tariffs on Chinese goods in response to Russian oil imports, unless European countries do so first.

In summary, policy uncertainty remains significant but more dramatic downside consequences of US tariffs and more extreme scenarios are attracting lower probabilities than had been the case in April. Evidence of effective redirection of trade flows and a spectrum of policy support measures have thus far insulated the global activity from a sharper downturn, although we remain in unchartered waters. Fresh record highs for the price of gold demonstrates the lack of confidence investors have around the US Dollar as the Fed cut into rising inflation and with questions about their independence as well as broader uncertainty, but stock markets are also at record highs in a range of locations.

Domestic economy

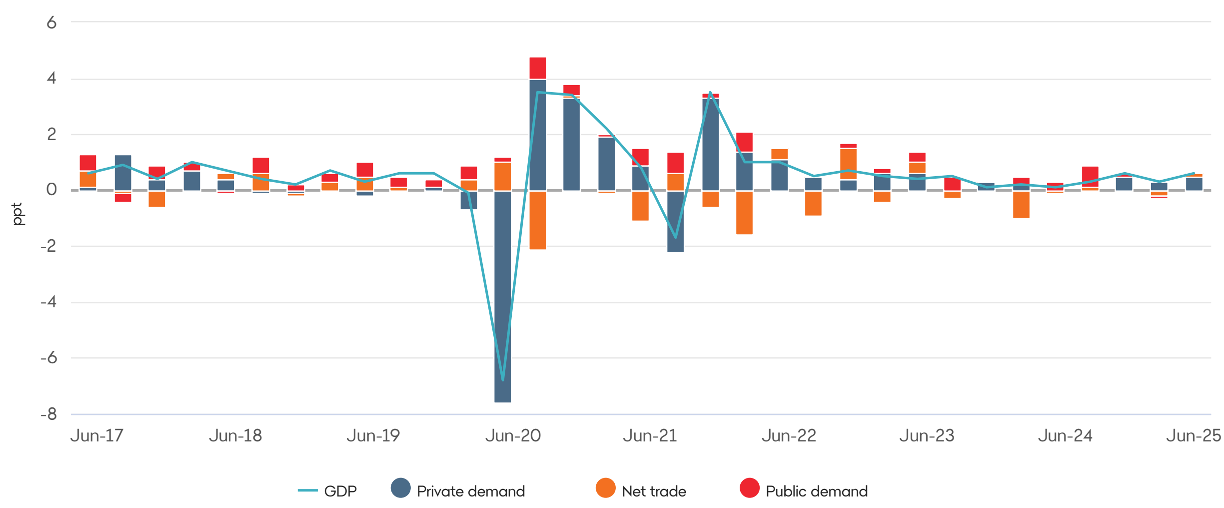
Despite the challenging fast-moving global backdrop outlined above, Australia's economy appears to be in a benign sweet-spot: underlying inflation is on target, labour markets are easing but still resilient and economic growth has rebounded more quickly than the RBA had forecast. Data continues to align to the expectation that official rates will be eased down to a more neutral level at a steady pace, but the case for cuts below neutral (i.e. below 3%) does not appear compelling at this stage. Scenarios that may require deeper cuts (a worsening in global trade tensions, especially for our major trading partners - or an unexpected jump in our unemployment rate) are not trivially unlikely but their likelihood is lower than back in April. As such we continue to expect the next rate cut in November, but do not expect any change in the next meeting at the end of September.

The monthly CPI indicator for July released late last month did show a surprising jump in both headline CPI (from 1.9 to 2.8% y/y) and in underlying inflation with the Trimmed Mean rising to 2.7%, but this monthly series was running well ahead of the full quarterly data where CPI is 2.1% and the TM 2.7%. The jump was attributed to some one-off factors such as state-based energy rebates and an unexpected jump in travel prices, so no doubt the RBA will place greater importance on the Q3 CPI data to be released in late October - but this monthly data suggests that there is no case for a back-to-back RBA rate cut, so borrowers will need to wait until November for any further rate relief.

Economic activity rebounded more strongly than expected in the latest national accounts data with 0.6% growth in the second quarter and 1.8% growth through the year, helped by a much stronger contribution from households. Consumer spending had been expected to recover this year as rising real household disposable income benefitted from RBA rate cuts and less of a drag from inflation, but this jump in household consumption (up 0.9% q/q) was earlier and stronger than forecast. We continue to expect rising consumer sentiment to drive discretionary spending thereby lifting SME business sentiment, and the latest business survey (for August) did see 'conditions' rise another 2 points to around their long-term average. Combining this data with jobs data, population flows and housing markets, there is still evidence of a three-speed economy with QLD and WA leading the way and Victoria in the slow-lane; but all regions are seeing improvements in sentiment and activity. Our basecase forecasts below continue to show real GDP growth exceeding 2% nationally in 2026.

The August labour market report was a mixed bag with a surprise 41k fall in full-time employment but a decrease in the participation rate leaving unemployment unchanged at 4.2% seasonally adjusted; but rising to 4.3% in trend terms (refer appendix). Hours worked fell 0.4% in August, although underemployment is still relatively low around 5.75%. The RBA recently described labour markets as remaining tight but having eased slightly, and as the appendix shows employment intentions suggest some upside risks to unemployment, especially with the care-economy and public sector likely to continue to wind back their pace of hiring. This is all still consistent with no need for restrictive interest rates (hence the path back to a neutral cash rate) but with more green shoots evident in the private sector our economy does appear in reasonable shape, despite the lack of progress on productivity and housing affordability. The Aussie Dollar briefly reached 67c as US dollar weakness continued and with some key commodities still in demand, but while the basecase forecast below continues to favour a higher A$ the path ahead is unlikely to be smooth.

Contributions to quarterly growth in GDP, chain volume measures, seasonally adjusted



Source: Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product June 2025

Interest Rate Outlook

The RBA (three cuts into their easing cycle) remain on the path back to a more neutral Official Cash Rate likely to continue via quarterly 25 bp cuts. While there is some uncertainty as to the precise level of 'neutral', two more cuts down to 3.1% remains our unchanged basecase scenario detailed below. The path beyond neutral is much more challenging to anticipate, with deeper cuts possible if trade tensions reemerge, and conversely less cuts if labour markets tighten further, but the consensus view of a trough in the OCR next year appears most sensible. After this a tightening cycle in FY27 is likely.

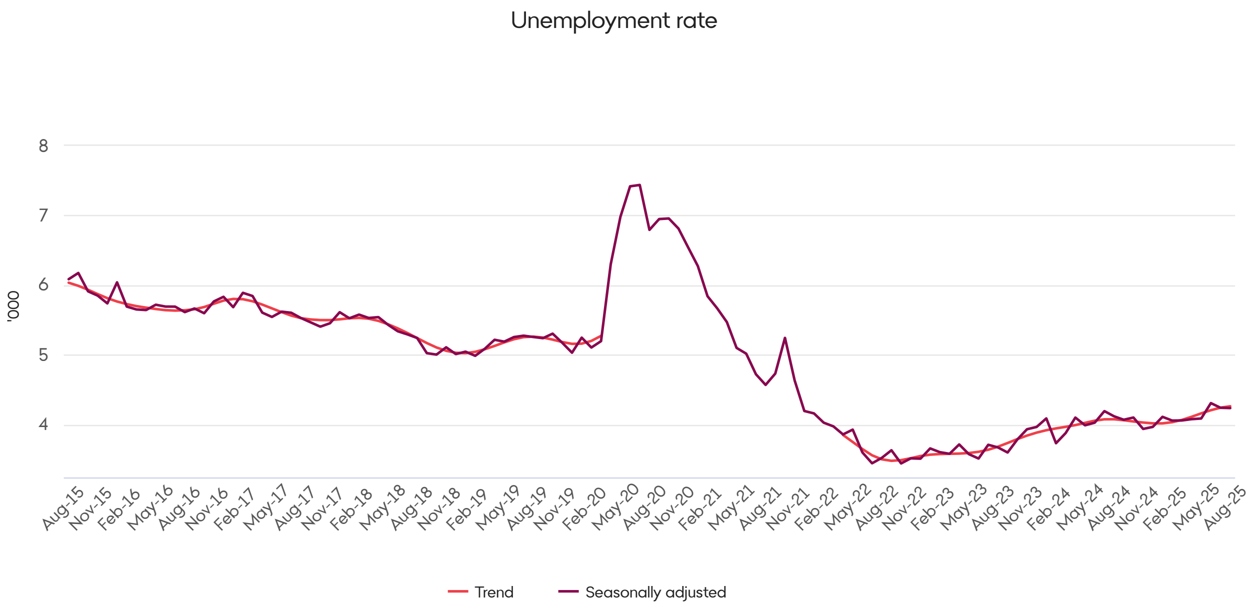
Economic Forecasts: basecase scenario

	2024			2025				2026				2027
% (actual, forecast)	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2
GDP q/q	0.2	0.3	0.6	0.3	0.6	0.5	0.6	0.5	0.7	0.6	0.6	0.7
GDP y/y	0.9	0.8	1.3	1.4	1.8	2.0	2.0	2.2	2.3	2.4	2.4	2.6
Unemployment	4.1	4.1	4.0	4.1	4.3	4.4	4.6	4.8	4.9	5.0	5.1	5.2
CPI (q/q)	1.0	0.2	0.2	0.9	0.7	0.9	0.5	0.6	0.7	0.9	0.7	0.7
CPI (y/y)	3.8	2.8	2.4	2.4	2.1	2.7	3.0	3.0	2.7	2.7	2.9	3.0
CPI (core y/y)	4.0	3.6	3.3	2.9	2.7	2.6	2.7	2.7	2.7	2.8	2.9	3.0
RBA cash rate	4.35	4.35	4.35	4.10	3.85	3.6	3.35	3.1	3.1	3.1	3.1	3.6
AUD / USD	.667	.691	.619	.625	.658	.67	.69	.71	.73	.75	.76	.75

Benchmark rates

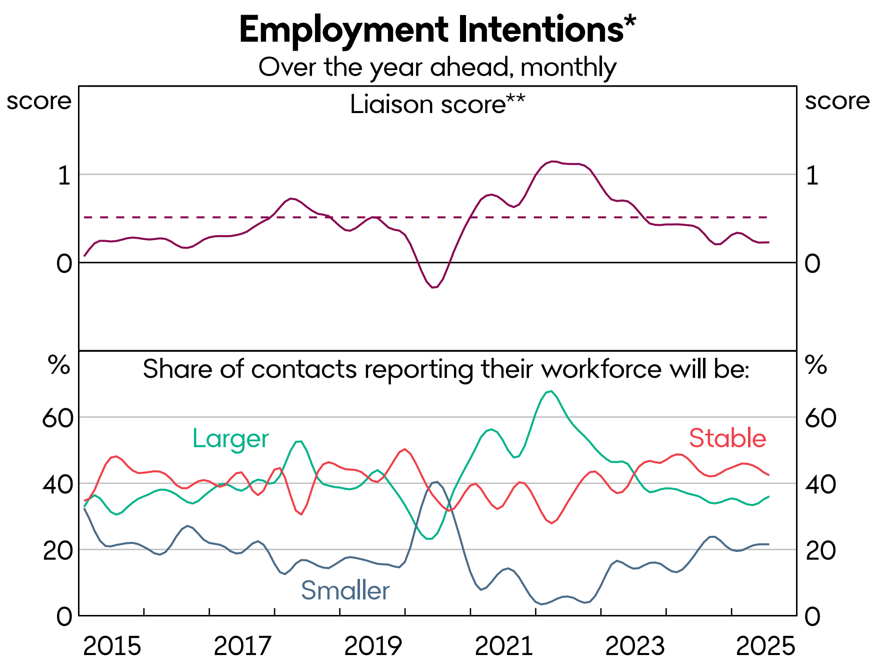
	31 / 7 / 24	31 / 7 / 2025	31 / 8 / 2025	18 / 9 / 2025
90-day bills	4.49%	3.68%	3.57%	3.55%
3-year swap	3.82%	3.34%	3.31%	3.34%
5-year swap	4.00%	3.77%	3.70%	3.72%
AUD/USD	.6540	.6425	.6540	.6615
ASX 200	8 092	8 639	8 973	8 745
Credit Index (iTraxx- 5 yr)	64.9	71.3	66.8	60.9

Appendix: Labour markets



Large month-to-month changes occurred during the COVID-19 pandemic, resulting in multiple trend breaks. The ABS recommends caution when using trend estimates published in spreadsheets in this release for this period. Information on trend breaks can be found in Labour Force, Australia methodology, August 2025

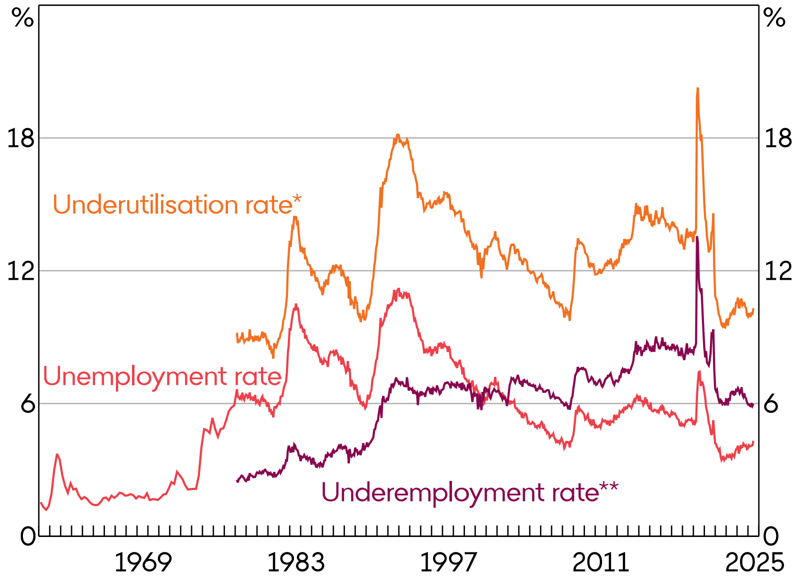
Source: Australian Bureau of Statistics, Labour Force, Australia August 2025



* Smoothed with a 13-month Henderson trend.
** Dashed line shows average since 2003; a score of 0 indicates no change.
Source: RBA.

Labour Underutilisation Rates

Heads-based



* Sum of the unemployment and underemployment rates.

** Employed people who want, and are available, to work more hours.

Source: ABS.